

EDITORIAL

## Towards a Ribā-Free Pakistan: 26th Constitutional Amendment and the Way-Forward

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Editor, Journal of Islamic Business and Management

The elimination of ribā (interest) has been a longstanding aspiration of the people of Pakistan. This goal is rooted in the nation's desire to align its financial system with Islamic principles. Earlier, Article 38 (f) of the Constitution provided a policy principle to “eliminate Riba as early possible”. However, the interest-free system could not be adopted despite the passage of 50 years. While the Federal Shariat Court (FSC) reiterated in its judgment of February 2022 that interest is ribā and must be eliminated from the economy by December, 2027, 26<sup>th</sup> amendment provided a clear timeline mandating the State of Pakistan to eliminate the ribā from the country by January 01, 2028. This landmark amendment in the Constitution requires the government and the regulators of banking and nonbanking business and finance institutions to take urgent and well-thought-out steps for the transition of the economy to ribā-free bases.

As highlighted by the Federal Finance Minister Senator Muhammad Aurangzeb in SECP-IsDB-AAOIFI conference on Islamic capital market held at Karachi on 12 December 2024, the government of Pakistan is committed to transforming the financial ecosystem of the country in line with Shari‘ah principles. It's heartening to note that he underlined the need for a “*system that is not only in line with our faith but also capable of inclusive and sustainable economic growth*”. “*Only then, we will be able to extend the benefits of all our efforts to the citizens of Pakistan.*” *Islamic finance instruments are vital for mobilizing resources for critical sectors, including infrastructure development and poverty alleviation through Islamic social finance, while maintaining adherence to ethical and transparent principles. While planning the transitional process, we must ensure that Islamic finance is not only rooted in Shari‘ah principles but also practical, transparent, and capable of meeting the evolving needs of our people,*” he added.

It requires a paradigm change and puts heavy responsibility on the government, SBP, SECP and the Directorate of National Savings (DNS) in addition to the business and finance institutions and the finance practitioners. They need to implement value-based intermediation (VBI) to realize the objectives of Islamic finance, namely, protection and augmentation of wealth in a *halal* manner, fair distribution of returns, enhancement of social wellbeing, and lastly, generation of real economic activity. The FSC (2022) could not

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cover many laws and regulations mainly because the same were not challenged before it. There has to be a full-fledged Islamic finance law to repeal the current conventional law(s). The recently added chapter to the BCO, 1962 by the SBP does not serve the purpose. The Debt Act 1944, Securities Act of 2015, Securities and Futures Advisers (Licensing and Operations) Regulations 2017, the Futures Market Act of 2016, Mutual Funds Regulations 2008, PSX Single Stock Options Contracts Market Regulations, Public Offering Regulations 2017, Negotiated Deals Market (NDM) rules, Securities (Leveraged Markets and Pledging) Rules 2011 need to be overhauled. Other laws, rules, and regulations about the Pakistan Stock Exchange, PMEX, CDC, and National Clearing Company (NCCPL) also must be cleansed from ribā and other prohibited elements. Similarly, the practices like Securities Lending and Borrowing (SLB), Margin Financing System (MFS), 'Next Day Netting Facility (NDNF) 2017 may also be revised. Screening criteria for Shari'ah compliant companies also have to be changed. It requires that the currently operative ratios allowing interest-based lending, borrowing and investments by the companies may be gradually phased out by the end of 2027.

More importantly, no license should be issued or renewed by the SBP and the SECP to the entities doing interest-based business in the banking and non-banking sectors. It may be noted that SBP issued licenses to a number interest-based banks for new branches or digital banking even after the FSC judgment. Similarly, the SECP issued licenses to around 15 digital lending Apps after the ribā judgment. The SECP capped the annualized nano-loans rate limit at 10 times the SBP's policy rate. For instance, with the policy rate at 22%, the maximum rate was capped at 220% per year, translating to approximately 0.6% per day. If the Policy rate is 13 %, the APR would be 130 % p.a. Now, when the system is being transformed to conform to Islamic principles, SECP has to change the licenses to ensure that such apps provide finance only on the basis of Islamic modes like Murabaha, Salam, leasing, valid tawarruq (not organized),

Islamic banking and finance have the potential to enhance financial inclusion, appealing to individuals who have avoided conventional banking due to religious beliefs. This could lead to a rise in savings and greater accessibility to financial services. However, achieving a ribā-free economy requires systemic changes. The shift to a ribā-free financial system by 2028 comes with significant challenges, the most serious of which are transformation of public debt system to Islamic finance principles. Pakistan's reliance on external financiers like the IMF, World Bank, and Paris Club raises concerns about the availability of Shari'ah-compliant funding. While some international organizations may accommodate Islamic finance, traditional lenders might resist. To address this, Pakistan must explore innovative funding strategies, such as FDI, sustainability financing, and project-linked equity Sukūk. Developing a Shari'ah-compliant money creation system and monetary policy remains a pressing need. As we suggested in the editorial of the previous Issue of the JIBM, SBP may adopt the Full Reserve System (FRS) for the banks and financial institutions. It would resolve the issue of huge domestic debt and its servicing and make available resources for entrepreneurs in production, IT services and other socio-economic infrastructure sectors.

**The Way Forward to a New Era for Pakistan's Economy:** The 26th Constitutional Amendment guides Pakistan to a bold path to an equitable and sustainable economic model. Banks as financial intermediaries must link the savers with the businesses and the production units so that the created wealth is distributed equitably among all according to their capacity. By addressing existing challenges head-on and leveraging the opportunities presented by Islamic finance, Pakistan has the chance to lead the way in creating a ribā-free financial system.

The FSC Judgment (2022) is a commendable judicial development towards Islamization of the financial and economic system in the country. The benchmark for the desired economic system should be avoiding *ribā* and *gharar* in all forms and implementing the *Principles of Policy* laid down in the Constitution of the Islamic Republic of Pakistan. It's what the FSC (2022) directed in Para 155 of its judgment. This journey requires unity, dedication, and innovation, which of course, offers the promise of a more inclusive and faith-aligned economic future for the nation. Islamic social finance institutions, fintechs, MFIs, and start-ups operating with the paradigm of mutual help for co-existence have the capacity to deliver solutions with the support of the state and the regulators.

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